Standing Committee on Company Law Reform (SCCLR)

Twenty-First Report to the Chief Executive in Council

Subjects considered by the

Standing Committee during 2004/2005

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PREFACE

(i)

Terms of Reference of the
Standing Committee on Company Law Reform

(1) To advise the Financial Secretary on amendments to the Companies Ordinance as and when experience shows them to be necessary.

(2) To report annually through the Secretary for Financial Services and the Treasury to the Chief Executive in Council on those amendments to the Companies Ordinance that are under consideration from time to time by the Standing Committee.

(3) To advise the Financial Secretary on amendments required to the Securities Ordinance and the Protection of Investors Ordinance Note 1 with the objective of providing support to the Securities and Futures Commission in its role of administering those Ordinances.

(ii)

Membership of the Standing Committee for 2004/2005

Chairman : Mr Benjamin YU, S.C.

Members : Mr Roger T BEST, JP (up to 31.1.2005)
           Mr Winston POON Chung-fai, SC (up to 31.1.2005)
           Mr Alvin WONG Tak-wai (up to 31.1.2005)
           Mr Randolph G SULLIVAN
           Mr Peter WONG Shiu-hoi
           Mr Richard J THORNHILL (up to 31.1.2005)
           Mr Michael W SCALES
           Mr William TAM Sai-ming
           Professor Stephen CHEUNG Yan-leung (up to 31.1.2005)

Note 1 These two Ordinances were consolidated into the Securities and Futures Ordinance which commenced on 1 April 2003.
Mr John POON Cho-ming
Mr David P R STANNARD
Ms Teresa KO Yuk-yin (from 1.2.2005)
Mr Godfrey LAM Wan-ho (from 1.2.2005)
Mrs Vanessa STOTT (from 1.2.2005)
Mr Carlson TONG (from 1.2.2005)
Mr Paul F WINKELMANN (from 1.2.2005)
Mr Patrick WONG Chi-kwong (from 1.2.2005)

Ex-Officio Members:
Mr Ashley ALDER (up to 22.10.2004)
Executive Director (Corporate Finance)
The Securities & Futures Commission

Mr Andrew YOUNG (from 23.10.2004)
Chief Counsel, Legal Services Division
The Securities & Futures Commission

Mr Paul CHOW
Chief Executive
Hong Kong Exchanges and Clearing Limited

Mr Charles BARR
Department of Justice

Mr E T O’CONNELL
The Official Receiver

Mr Gordon W E JONES, JP
The Registrar of Companies

Mr William RYBACK
Deputy Chief Executive
The Hong Kong Monetary Authority

Mrs Clarie K L LO, JP (up to 1.8.2004)
Deputy Secretary for Financial Services and the Treasury
Meetings held during 2004/2005

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<td>17 April 2004</td>
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<td>27 April 2004</td>
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<td>One Hundred and Eighty-Second Meeting</td>
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<td>One Hundred and Eighty-Fourth Meeting</td>
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<td>One Hundred and Eighty-Fifth Meeting</td>
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<td>One Hundred and Eighty-Sixth Meeting</td>
<td>8 December 2004</td>
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<td>One Hundred and Eighty-Seventh Meeting</td>
<td>29 January 2005</td>
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<td>One Hundred and Eighty-Eighth Meeting</td>
<td>5 March 2005</td>
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EXECUTIVE SUMMARY

The Standing Committee on Company Law Reform (SCCLR) was formed in 1984 to advise the Financial Secretary on amendments to the Companies Ordinance and other related ordinances. The SCCLR reports annually through the Secretary for Financial Services and the Treasury to the Chief Executive in Council on amendments that are under consideration.

From 1 April 2004 to 31 March 2005, the SCCLR held 12 meetings including a special meeting called specifically to discuss an issue raised by the Bills Committee set up by the Legislative Council on the proposed statutory derivative action in the Companies (Amendment) Bill 2003.

On completion of the four years long Corporate Governance Review, the SCCLR spent the majority of the year on two main areas. These were the review of the offences and punishment provisions of the Companies Ordinance and the examination of the proposals and recommendations made by the Joint Government/HKICPA Working Group (JWG) set up to review the accounting and auditing provisions of the Companies Ordinance, including a paper on the JWG’s recommendation to give statutory recognition to accounting standards.

During the reporting period, the SCCLR discussed the way forward with regard to the proposal to rewrite the Companies Ordinance and endorsed the terms of reference for the rewrite. It also considered two Consultation Papers related to the giving of statutory backing to major listing requirements; and a Consultancy Study
Report on the Implications of Adopting a No-Par Value Share Regime in Hong Kong.

With regard to the former, the SCCLR agreed generally with the broad principles of enhancing the regulation of listing through giving statutory backing to major listing requirements and ongoing disclosure obligations but had reservations and concerns on a number of practical issues. As to the latter, the SCCLR agreed with the consultant’s conclusion that Hong Kong should adopt a mandatory regime of no-par value shares for all companies incorporated in Hong Kong but at the same time recommended that further research and public consultation on the subject should be undertaken.

A brief summary of the nine chapters in this Annual Report is set out in the following table :-

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<th>Chapter</th>
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<tr>
<td>1</td>
<td>Review of the Offences and Punishment Provisions of the Companies Ordinance</td>
<td>Members agreed to a number of broad principles with regard to the number and categorisation of company law offences; the balance between civil and criminal sanctions; and whether the company or company officers should be liable.</td>
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| 2       | Statutory Derivative Action in the Companies (Amendment) Bill 2003 | Members were generally of the view that –  
• a trial within a trial should be avoided as far as possible;  
• if a leave requirement was }
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| 3       | Overall Review of the Companies Ordinance | Members agreed that –  
• the proposed rewrite of the companies’ Ordinance... |
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<td>Companies Ordinance should be the last phase of the company law reform programme picking up from the SCCLR’s recommendations made in its Report on the Recommendation of a Consultancy Report of the Review of the Hong Kong Companies Ordinance in 2000 and other subsequent reviews undertaken by the SCCLR; and • the proposed terms of reference for the rewrite were acceptable, subject to some minor amendments, but there was no need for them to be put out for consultation so long as the public was aware of what was happening and had the channels to express their views. Members also endorsed, subject to minor amendments, the proposed framework for the new Companies Ordinance.</td>
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4  |  A Consultation Study Concerning the Implications of Adopting a No-Par Value Share Regime in Hong Kong | Members recommended that –  
- Hong Kong should adopt a mandatory regime of no-par value shares for all companies incorporated in Hong Kong;  
- further research on the Australia and New Zealand models of no-par regime and the related capital maintenance issues should be done in the context of the overall rewrite of the Companies Ordinance; and  
- matters requiring further public consultation should be dealt with by the Administration taking into account the points raised by members during the deliberation.  

5  |  Draft Drafting Instructions in Relation to Proposals Made by the SCCLR in Phase II of the Corporate Governance Review | Members clarified a number of policy issues regarding –  
- the nomination and election of directors;  
- company general meetings;  
- the provisions under sections 58, 166 and 168 of the Companies
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| 6       | Draft Drafting Instructions in respect of Accounting Provisions in the Companies Ordinance and Mock-Up of the Proposed Accounting Provisions Prepared by the JWG | Members endorsed the following changes in principle recommended by the JWG –  
  - the sequence of the accounting provisions should be re-arranged in a more coherent and logical manner;  
  - the terminology of the provisions should be updated;  
  - the introduction of provisions regarding –  
    - accounting reference dates, accounting reference periods and financial years;  
    - directors’ emolument requirements;  
    - directors’ remuneration report;  
  - a company’s obligation to prepare individual financial statements where the company is a holding |
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<td>company and has prepared consolidated financial statements should be removed; and</td>
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<td>• auditors should be required to report on all annual financial statements and the auditable part of the directors’ remuneration report.</td>
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Members expressed reservations on the following changes in principle recommended by the JWG :-

- the proposed repeal of the accounting disclosure requirements in the Tenth Schedule to the Companies Ordinance;
- there was no need to give statutory recognition to or backing for accounting standards;
- the introduction of a directors’ declaration requirement; and
- the trimming down of the disclosure requirements in the directors’ report.
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<td>7</td>
<td>Draft Drafting Instructions in respect of Auditing Provisions in the Companies Ordinance and Mock-up of the Proposed Auditing Provisions Prepared by the JWG</td>
<td>Members endorsed the JWG’s proposal to improve, modernize and simplify the auditing provisions of the Companies Ordinance on the basis of the recommendations in Part 6 of the draft clauses published in the United Kingdom White Paper regarding the reform of the Companies Act which was published in July 2002. However, this was on the understanding that the JWG would further review the proposals when the United Kingdom Company Law Reform White Bill was published. The proposals included, inter alia, the following:-</td>
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- the sequence of the auditing provisions should be re-arranged in a more coherent and logical manner;
- auditors should be required to report on any inconsistencies between audited financial statements and financial information in other parts of the
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<td>annual report, and also to report on the auditable part of any directors’ remuneration report;</td>
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<td>• auditors’ rights to obtain information should be significantly enhanced on the basis of sections 389A and 389B of the United Kingdom Companies (Audit, Investigations and Community Enterprise) Act 2004;</td>
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<td>• auditors’ rights in relation to general meetings should be enhanced;</td>
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<td>• outgoing auditors should have the right to give information that he became aware of in his capacity as such to incoming auditors;</td>
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<td></td>
<td>• an outgoing auditor should have the obligation to give an incoming auditor a statement of any circumstances connected with his ceasing to hold office that should in his view be brought to the attention of the members or creditors of the company;</td>
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and

- resigning auditors should have the
right to call an extraordinary
general meeting to explain the
circumstances connected with their
resignation if the directors failed to
do so upon being requisitioned.

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<td>Consultation Paper on Proposed Amendments to the Securities and Futures Ordinance to Give Statutory Backing to Major Listing Requirements and Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules</td>
<td>Members agreed generally with the broad principles to enhance the regulation of listing through giving statutory backing to major listing requirements and ongoing disclosure obligations including, inter alia, the introduction of civil fines on issuers and directors for breaches of the statutory listing requirements. However, they expressed concern on a number of practical issues, such as the phasing out of the pre-vetting of disclosure materials arrangements; the exact roles of the SEHK and the SFC in the regulatory framework; the future arrangements for the Listing Rules after the promulgation of the statutory rules; and the co-operation</td>
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<td>9</td>
<td>The Recommendations of the JWG to Give Statutory Recognition to Accounting Standards upon the Removal of the Tenth Schedule to the Companies Ordinance</td>
<td>Members expressed preliminary views on a number of broad issues relating to the subject without going into the details of the JWG’s recommendations. The matter would be referred back to the SCCLR for further consideration at a later stage when the Administration had assessed the policy implications of the recommendations, including consultation with the relevant stakeholders such as the HKICPA.</td>
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CHAPTER 1

Review of the Offences and Punishment

Provisions of the Companies Ordinance

Background

1.1 The SCCLR recommended in the Report on the Recommendations of a Consultancy Report of the Review of the Hong Kong Companies Ordinance issued in February 2000 that the question of offences and punishment in the Companies Ordinance should be further studied.\textsuperscript{Note 2}

1.2 At the 165th meeting of the SCCLR on 13 October 2000, it was agreed that the offences and punishment provisions of the Companies Ordinance would be reviewed by the Companies Registry with the intention of submitting a further paper to the SCCLR in due course.

1.3 Subsequent to this decision, the Companies Registry’s Legal Services Division undertook considerable research into the offences and punishment provisions of the Companies Ordinance and prepared a very comprehensive paper on the subject. The Paper reviewed not only the relevant provisions of the Companies Ordinance but also those in the United Kingdom (“UK”), Australia and Singapore, and their respective proposed reforms (if any) under the following headings :-

\textsuperscript{Note 2} Recommendation 145 at page 211 of the Report.
the number and categorization of offences;
• the balance between civil and criminal sanctions; and
• whether the company or company officers should be liable.

1.4 The Paper also contained a detailed comparison of the company law offences in Hong Kong and the UK.

1.5 At the 177th, 179th, 180th and 181st meetings on 17 April 2004, 8 May 2004, 26 June 2004 and 11 September 2004, members considered the paper. At the 180th and 181st meetings, a further paper on the questions raised at the previous discussions was also considered.

Recommendations

1.6 Members approved certain broad principles as follows:-

(a) The insolvency and prospectus related offences should be excluded from the subject review.

(b) There should not be an “all encompassing offence” to cover any contravention of the Companies Ordinance in respect of which there is no specific offence.

(c) The company law offences in the Companies Ordinance should be categorized into –
• dishonesty offences;
• intermediate offences; and
• regulatory offences (which should be strict liability
(d) The current Twelfth Schedule to the Companies Ordinance should be reviewed and simplified in the light of the proposed replacement of the Twenty-fourth Schedule to the Companies Act in the UK.

(e) No change should be made to the existing maximum penalty applicable to serious dishonest conduct such as fraudulent trading.

(f) A statutory penalty notice system Note 4 should not be adopted in Hong Kong.

(g) The concept of directors’ disqualification undertaking Note 5 in the UK was generally agreeable but should be subject to further study/discussion and public consultation.

(h) Measures corresponding to the automatic directors disqualification in Australia or a director disqualification order by the relevant authority (other than the court) should not be introduced in Hong Kong.

(i) No decision should be made, for the time being, on whether civil

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Note 3 "Dishonesty offences" involve full mens rea such as the offences of making a false statement under ss 291AA(14), 349 and 233(3) of the CO relating to any document required to be filed under any provision under the CO. "Intermediate offences" relate to the conduct by ‘officers’ in the management of a company that give rise to obligations (with respect to some form of disclosure) to the company and its members; and “regulatory offences” are strict liability in nature, such as the lodgment by companies of annual returns and other documents required to be filed in the CR within a prescribed time.

Note 4 Under a penalty notice system, a penalty notice may be issued by the authority to a person who is believed to have committed an offence, requiring the person to pay a penalty in respect of that offence without instituting criminal prosecution proceedings. A person who fails to pay the penalty as required will be prosecuted. Both Australia and Singapore have a penalty notice regime in respect of company law offences.

Note 5 The Insolvency Act 2000 of the UK introduced the disqualification undertaking in which the Secretary of State for Trade and Industry may, instead of applying to the court for a directors disqualification order, accept a disqualification undertaking from individuals if it appears to him that it is expedient in the public interest that he should do so.
penaltiesNote 6 should be extended to breaches of the company law which were at present regarded as criminal. A “wait and see” approach should be adopted to see how the proposed legislative amendments to the Securities and Futures Ordinance on using civil penalties to regulate market misconduct would develop. Note 7 More information should be obtained on how the civil penalty provisions had worked in other jurisdictions and advice should also be sought on the issue from a human rights perspective from the Department of Justice.

(j) A “reporting” systemNote 8 should not be adopted in Hong Kong to deal with company law offences.

(k) The existing “striking off” system had been working well and there was no need to have it expanded.

(l) Company law offences should not be decriminalized.

(m) The need to strengthen existing criminal sanctions should be considered in the context of reviewing individual offences.

(n) The current system of providing the prosecution with an option of proceeding against the company or the officers in default should be maintained.

(o) The term “officer in default” should be re-defined along the lines of clause 210 of the UK draft Companies Bill. Note 9

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Note 6 Civil penalties are punitive sanctions that are imposed other than through the normal criminal process and are often financial in nature.

Note 7 Under the legislative proposals to give statutory backing to the Listing Rules, considerations were being given as to whether the Market Misconduct Tribunal and/or the SFC should be given power to impose fines in addition to a power to order disgorgement of profit made or loss avoided.

Note 8 Under a “reporting” system, companies would be required to provide a record of conviction of the company or its officers of the company law offences for public information.

Note 9 "Modernizing Company Law - Draft Clauses" (presented to the UK Parliament by the Secretary
(p) The term “officer” should be re-defined along the lines of clauses 208 and 209 of the UK draft Companies Bill. Note 10

(q) The current law on service of documents on companies was, on the whole, adequate, but consideration might be given to the need to state expressly in the Companies Ordinance the circumstances under which service would be regarded as good under the existing “deeming” provision. The administrative practice of the magistrate’s court should also be reviewed in the light of the current law.

(r) The current inspection and investigation provisions of the Companies Ordinance should be reviewed to see if there were any deficiencies. If wider investigative powers were to be given to the Companies Registry, clear evidence must be shown that the investigative powers at present in the Companies Ordinance were insufficient.

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Note 10 "In Modernizing Company Law - Draft Clauses" published in July 2002, the UK Government proposed to attribute criminal liability to two newly created categories of person, namely

- responsible office-holder and
- responsible delegate

Responsible office-holder is defined in Clause 208 of the draft Companies Bill as :-

"(a) a director
(b) a secretary of the company if the function of securing compliance with the specified enactment was properly delegated to the secretary ......
(c) a manager of the company whose functions include securing compliance with the specified enactment.”

Responsible delegate is defined in Clause 209 as "any person (other than a director, secretary or manager of the company) to whom the function of securing compliance with the specified enactment was properly delegated by one or more of ....... a director or a secretary of the company.”
CHAPTER 2

Statutory Derivative Action

in the Companies (Amendment) Bill 2003

Background

2.1 In its Consultation Paper on Proposals made in Phase I of the Corporate Governance Review, the SCCLR proposed, inter alia, the introduction of a statutory derivative action (“SDA”) to make it clear that there would be no “trial within a trial” for the purpose of determining the standing of an applicant to commence a derivative action on behalf of the company.

2.2 The proposal was accepted by the Government and incorporated into the Companies (Amendment) Bill 2003\(^\text{Note 11}\) which was introduced into the Legislative Council on 25 June 2003.

2.3 The Bills Committee set up by the Legislative Council to scrutinize the Bill asked the Administration to consider the imposition of a ‘leave requirement’ for the commencement of a SDA. Subsequently, the FSTB referred the matter to the SCCLR for discussion at the 176th (special) meeting on 8 March 2004.\(^\text{Note 12}\)

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\(^{Note 11}\) The Companies (Amendment) Bill 2003 was enacted as the Companies (Amendment) Ordinance 2004 on 22 July 2004. Schedule 4 of the Bill containing amendments relating to shareholders’ remedies (which included SDA) has become Schedule 3 in the Companies (Amendment) Ordinance 2004.

\(^{Note 12}\) Please see Chapter 7 of the 20th Annual Report of the SCCLR.
2.4 In addition, the Bills Committee raised a number of further queries on the proposed SDA including, inter alia, the following three particular issues:

- the co-existence of the common law derivative action (“CDA”) and the SDA;
- the conduct of the proceedings; and
- the scope of the proceedings.

2.5 In view of this, the FSTB issued a Consultation Paper to obtain views on these issues which was discussed by the SCCLR at the 178th (special) meeting on 27 April 2004.

**Recommendations**

2.6 Members generally felt that, because of the very limited time that had been made available for them to respond, it was not possible to undertake an in-depth study on the ramification of the various proposals. Despite this, the general comments and views of the majority of the members were as follows:

(a) A trial within a trial should be avoided as far as possible.

(b) If a leave application was considered necessary, the threshold must be set at a meaningfully low level.

(c) The proposed thresholds of “good faith” and “in the best interest of the company” were too high and might force the court to enter into the merits of the claims in cases where there were conflicting evidence and serious dispute of facts.
(d) There would be no need for the co-existence of the SDA and CDA if jurisdiction was conferred on the Hong Kong court to deal with SDAs by members of unregistered companies which had substantial connections with Hong Kong.

(e) The scope of the SDA should be limited to such grounds as fraud, negligence, default in relation to any laws or rules and breach of fiduciary or statutory duty.

(f) Some research ought to be undertaken as to how the SDA had fared in Australia and in Singapore and whether there was any evidence of derivative actions being abused in Hong Kong.
CHAPTER 3

Overall Review of the Companies Ordinance

Background

3.1 The SCCLR’s Report on the Recommendation of a Consultancy Report of the Review of the Hong Kong Companies Ordinance (SCCLR’s Report), which was published in February 2000, made 62 recommendations for reform. These have been divided into four phases, namely Phases I to IV, for follow-up action.

3.2 All the recommendations in Phase I have already been enacted into law through the Companies (Amendment) Ordinance 2003. Some of the recommendations in Phases II (corporate governance-related) and III (non-corporate governance issues requiring further study) have been included in the Companies (Amendment) Ordinance 2004. However, many of the remaining recommendations cannot, by their nature, proceed in the context of stand-alone companies amendment bills and will have to proceed in the context of the overall rewrite of the Companies Ordinance.

3.3 At the 175th meeting on 21 February 2004, the SCCLR considered Progress Report No. 4 on the Overall Review of the Companies Ordinance and agreed a number of key points on the process and procedure regarding the
rewrite of the Companies Ordinance.\footnote{13}

3.4 In order to give further consideration to these key points and other related issues, the Registrar of Companies formed a small Working Group, which met on 29 April 2004, to develop proposals for further consideration by the SCCLR. A follow-up paper containing details with regard to the terms of reference; the framework for the new Hong Kong Companies Ordinance; and the work plan, the structure and the timetable for the rewrite was prepared.

**Recommendations**

3.5 At the 180th meeting on 26 June 2004, the SCCLR considered this paper and members agreed, inter alia, that :-

(a) The proposed rewrite should be the last phase of the company law reform programme picking up from the recommendations made in the SCCLR’s Report in February 2000 and other subsequent reviews undertaken by the SCCLR.

(b) The proposed terms of reference for the rewrite were acceptable, subject to some minor amendments, and there was no need to put them out for consultation so long as the public was aware of what was happening and had the channels to express their views.

3.6 Subject to minor amendments, the SCCLR endorsed also the proposed

\footnote{13}{Please see Chapter 6 of the 20th Annual Report of the SCCLR.}
framework for the new Hong Kong Companies Ordinance.
CHAPTER 4

A Consultation Study Concerning the Implications of
Adopting a No-Par Value Share Regime in Hong Kong

Background

4.1 The idea of prohibiting par value shares was first raised in the Consultancy Report on the Review of the Companies Ordinance published in March 1997. In 1999, a special Task Force was set up under the SCCLR to undertake further study of the subject with particular reference as to how it had been handled in other jurisdictions. In late 1999, the Task Force completed the study and recommended that a no-par value share regime should be adopted in that –

- existing companies and those incorporated before a specified date would have the option to convert to or issue no-par value shares; and
- all companies incorporated after the specified date would have to issue no-par value shares.

4.2 The Task Force’s recommendations were considered by the SCCLR at the

Note 14 Recommendation 4.02 stated as follows – “No par value shares. Par value shares should be prohibited”.

Note 15 There is no essential difference between a share of no par and one having a par value. Both represent a share, being a fraction or an aliquot part of the equity, but the par value share has attached to it a label of value, and the share without par value does not. In a par value system, it is usual to state the share capital as “$X divided into y shares of $2 each”. The share therefore has a label proclaiming that its par value is $2. On the other hand, a no-par system would simply represent the capital as “$X divided into y shares”.

142nd meeting on 11 September 1999. It was decided that a no-par value share regime should be adopted in Hong Kong but it should be optional for all companies whether they were existing companies or new companies after a specified date. This recommendation was included in the SCCLR’s Report on the Recommendation of a Consultancy Report of the Review of the Hong Kong Companies Ordinance published in February 2000.\textsuperscript{Note 16}

4.3 At the 154th meeting on 10 February 2001, the SCCLR further revisited the subject. At the meeting, the SCCLR reconfirmed its previous recommendation for an optional no-par value share system but agreed that it was not a priority issue.

4.4 In the light of the SCCLR’s recommendation, the Administration considered at a later meeting in May 2001 that the issue should be given further detailed consideration in the context of a consultancy study. In July 2002, a law firm in the private practice was selected as the consultants for the study. The study commenced in November 2002.

4.5 The consultation study basically examined the desirability of migrating to a no-par system; giving particular attention to the operation of the no-par system in practice; the matters in respect of which safeguards were necessary; and the interests of investors, creditors and the wider public. The conclusion was that the principle of the no-par system was desirable and that it should be introduced in Hong Kong on a mandatory basis for all

\textsuperscript{Note 16} Recommendation 114 at page 177 of the Report stated that “The Committee recommends that company law should permit no par shares for all companies on an optional basis.”
companies incorporated in Hong Kong with a share capital. There was, however, no pressing need to effect the change presently, although it would be efficient and preferable to consider it in the context of any review of the capital maintenance rules, and for the changes to be made together.

4.6 The Consultants finalized and submitted the Draft Final Report entitled “A Consultation Study concerning the Implications of Adopting a No-Par Value Share Regime in Hong Kong” to the FSTB on 20 August 2004. At the 183rd meeting on 9 October 2004, the Consultants made a presentation on the Final Draft Report to the SCCLR.

**Recommendations**

4.7 As a result of the discussion, subsequent to the presentation, members recommended that:

(a) Hong Kong should adopt a mandatory regime of no-par value shares for all companies incorporated in Hong Kong. Note 17

(b) Further research on the Australian and New Zealand models of a no-par regime and the related capital maintenance issues should be dealt with in the context of the Overall Rewrite of the Companies Ordinance; and

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Note 17 This recommendation will be considered further in the context of the rewrite of the Companies Ordinance.

Note 18 New Zealand migrated to a mandatory no-par system in 1993, and Australia in 1998. New Zealand implemented no-par without the concomitant concept of stated capital, legislating instead a solvency test for the protection of creditors. On the other hand, Australia preserved the capital maintenance rules of the par value system by reclassifying the share capital and premium under the par value system as stated capital.
(c) Matters requiring further public consultation should be considered and dealt with by the Administration taking into account the points raised by members during the discussion such as the timing and scope of public consultation on the issue of no-par value shares and capital maintenance.

4.8 In addition, while members were all in support of the consultation conclusions, they were concerned about how capital maintenance should be dealt with after the migration, and the practical difficulties linked to the migration from a par value system to a no-par value system.
CHAPTER 5

Draft Drafting Instructions in
Relation to Proposals Made by the SCCLR
in Phase II of the Corporate Governance Review

Background

5.1 In the Consultation Papers on Phases I and II of the Corporate Governance Review, the SCCLR made a number of recommendations :-

(a) to improve the current procedures for the nomination and election of directors in order to provide shareholders with a meaningful right to nominate and elect directors within the current framework;

(b) to enhance the effectiveness and transparency of company general meetings; and

(c) to rationalize the provisions in sections 58, 166 and 168 of the Companies Ordinance. Note 19

Note 19 There is a multiplicity of provisions in the Companies Ordinance providing for different forms of corporate restructuring. Section 58 provides a statutory scheme for companies to reduce their share capital. Section 166 provides for reorganization under which compromises or arrangements between a company and its creditors or between a company and its shareholders may be affected. Section 168 allows a transferee company to compulsorily acquire the shares of dissenting minorities in an amalgamation or merger. For more details, please see paragraphs 20.18 to 20.36 of SCCLR’s Consultation Paper on Proposals made in Phase II of the Corporate Governance Review.
5.2 In the course of preparing the draft drafting instructions to be sent to the Law Draftsman for drafting the necessary amendment bill for implementing the recommendations, a number of policy issues arose. These issues, together with the draft drafting instructions, were referred back to the SCCLR for further consideration and directions.

**Recommendations**

5.3 At the 182nd, 184th and 185th meetings on 28 September, 30 October 2004 and 27 November 2004, the SCCLR reconsidered the draft drafting instructions in the light of the policy issues which had arisen. As a result of the discussion, members agreed, inter alia, the following:-

(a) The proposed changes in relation to the nomination and election of directors should apply only to companies incorporated in Hong Kong. Members were of the view that the law should not interfere with the internal management of companies incorporated overseas. The nomination and election of directors in respect of such companies, if they were listed in Hong Kong, should be regulated by the Listing Rules.

(b) Listed and unlisted companies should be separately dealt with by two different sets of rules so far as the nomination and election of directors was concerned. There should therefore be a set of ground rules applicable to all companies but flexible enough to allow listed companies to operate according to the Listing Rules.

(c) A company’s obligation to circulate director nomination notices should be restricted to annual general meetings (“AGMs”) only.
The extension of the requirement to extraordinary general meetings ("EGMs") might open up the frame too wide, leading to a general right to elect directors at EGMs. Note 20

(d) The ability to opt out from the requirement to hold AGMs, if all the shareholders agreed, should apply to both public and private companies. Even though, in practice, there were unlikely to be many public companies in a position where not one single shareholder wished to hold an AGM, that possibility could not be ruled out. Note 21

(e) The SCCLR’s previous recommendation to permit postal and electronic voting should be held in abeyance for the time being. Further consideration was required on how such voting should be counted; Note 22 the effect it might have on the behavioral pattern of shareholders participating at AGMs; and how the change could be accommodated within the existing Central Clearing and Settlement System under which all securities had to be held in the name of the HKSCC Nominees Limited.

(f) Multiple proxies should not be permitted to vote on a show of

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Note 20 A meeting’s competence is limited by the business proposed to be dealt with at the meeting. Unlike an AGM whose routine business would include the election of director, an EGM is called to consider only specified resolutions as defined in the notice. Even though an EGM may, in theory, be called to elect directors to fill vacancies, such a situation will very seldom arise in reality because casual vacancies are usually filled by appointments made by the board. A director so appointed will hold office until the next AGM.

Note 21 The SCCLR has not stated in its original recommendation as to whether the ability to opt out of the requirement for AGMs should apply to both private and public companies. In Australia, there is no provision allowing public companies to dispense with holding of AGMs. In the UK, only private companies may opt to dispense with AGMs if all their members agree. Under Table A, there are two methods of voting:

(a) A show of hands — voters in favour of a resolution are asked to raise a hand each and are counted; the same is done for voters against the motion. Under this method, each voter, irrespective of the number of shares he holds, can be counted only once.

(b) A poll — a written record is made of each voter’s vote and the numbers for and against the motion are counted. By Regulation 64, on a poll, every member has one vote for
hands because it would go against the basis upon which the show of hand mechanism was premised, thus distorting the results.\footnote{22}

(g) The SCCLR’s previous recommendations with regard to sections 58, 166 and 168 of the Companies Ordinance\footnote{23} should not be further pursued because no reduction of capital would, in practice, result in inequitable treatment of shareholders.\footnote{24}

Members were also of the view that there was basically no inconsistency between the sanctioning criteria and the voting requirements under the two court procedures in sections 58 and 166. While section 168 did require a higher acceptance level of 90 percent or more of the shares in the company, the procedure under this section was basically not a court procedure.\footnote{25}

\footnote{23} The SCCLR recommended in the Final Recommendations of the Corporate Governance Review that section 58 should be amended to ensure greater consistency with section 166 so that, where a reduction of capital might result in different treatment of shareholders of equal standing or not rateably as between classes of shareholders, the procedure should be the same under section 166; and that sections 58, 166 and 168 should be rationalized so as to prevent compulsory acquisition being achieved other than under section 168. For details, please see page 28 of the SCCLR’s 20th Annual Report.

\footnote{24} One of the four essential criteria for sanctioning a reduction of capital is that the shareholders must be treated equitably and this applies to different classes. In fact, section 58(3) of the Companies Ordinance, as amended by the Companies (Amendment) Ordinance 2003 which came into operation on 13 February 2004, when setting out the only case whereby confirmation of reduction by the court is not required has expressly incorporated this common law position by stating that “the reduction applies to and affects all shares equally”.

\footnote{25} Under section 58, a company may by special resolution reduce its share capital. Court’s confirmation is required for any reduction unless the sole purpose of the reduction is to redesignate the nominal value of the shares to a lower amount and that the five conditions as set out in section 58(3) are met with.

Under section 166, a compromise or arrangement approved by a majority in number and three-fourths in value of the members (or creditors) present and voting at the meeting, shall, if sanction by the court, be binding on the members (or creditors) and the company.

Under section 168, a company which has acquired 90 percent or more of a company’s shares may buy the remaining shares compulsorily; the minority shareholders in such a situation may also insist on being bought out.
CHAPTER 6

Draft Drafting Instructions in respect of Accounting Provisions in the Companies Ordinance and Mock-Up of the Proposed Accounting Provisions Prepared by the Joint Government/HKICPA Working Group

Background

6.1 One of the recommendations of the Report of the SCCLR on the Recommendations of a Consultancy Report on the Review of the Hong Kong Companies Ordinance published in February 2000 was that “the Tenth Schedule of the Ordinance be updated and that the Hong Kong Society of Accountants’ (now renamed as HKICPA) offer of assistance in this respect be accepted”.

In addition, the Registrar of Companies noted that the SCCLR Report did not cover the accounting and auditing provisions of the Companies Ordinance.

6.2 In the light of these considerations, a Joint Working Group (entitled the Joint Government/HKICPA Working Group to Review the Accounting and Auditing Provisions of the Companies Ordinance) was formed to comprehensively review the accounting, auditing and financial reporting disclosure provisions of the Companies Ordinance.

Note 26 Recommendation 129 at page 198 of the Report.
6.3 The JWG held its first meeting on 19 March 2002 and, up to 31 March 2004, had held 34 meetings. Amongst other things, the JWG has prepared draft drafting instructions in respect of the accounting provisions in the Companies Ordinance and a mock-up of the proposed accounting provisions.

**Recommendations**

6.4 At the 185th and 186th meetings on 27 November 2004 and 8 December 2004, the SCCLR considered the draft drafting instructions in respect of the accounting provisions in the Companies Ordinance and mock-up of the proposed accounting provisions prepared by the JWG.

6.5 As a result of the discussion, members endorsed in principle a number of changes recommended by the JWG as follows:-

(a) The basic sequence of the accounting provisions should be re-arranged in a more coherent and logical manner.

(b) The accounting provisions should be improved to make them more user-friendly and comprehensible.

(c) The introduction of provisions regarding accounting reference dates, accounting reference periods and financial years.

(d) The terminology of the provisions should be updated.

(e) A company’s obligation to prepare individual financial statements where the company is a holding company and has prepared consolidated financial statements should be removed.

(f) The introduction of provisions relating to directors’ emolument
disclosure requirements.

(g) The introduction of provisions relating to a directors’ remuneration report.

(h) Auditors should be required to report on all annual financial statements and on the auditable part of the directors’ remuneration report.

6.6 Reservations were, however, expressed by members regarding the following changes in principle, which the JWG had agreed to reconsider -

(a) The proposed repeal of the accounting disclosure requirements in the Tenth Schedule of the Companies Ordinance Note 27 that were covered by accounting standards.

(b) There should be no statutory recognition to or backing for accounting standards.

(c) The introduction of a directors’ declaration requirement.

(d) The trimming down of the disclosure requirements in the directors’ report.

Note 27 The Tenth Schedule of the Companies Ordinance sets out inter alia, the general provisions as to the balance sheet and profit and loss account.
CHAPTER 7

Draft Drafting Instructions in respect of Auditing

Provisions in the Companies Ordinance and Mock-up of
the Proposed Auditing Provisions Prepared by the Joint
Government/HKICPA Working Group

Background

7.1 The JWG\textsuperscript{28} reviewed and examined the auditing provisions in the Companies Ordinance and prepared detailed draft drafting instructions and a mock-up of the proposed auditing provisions.

Recommendations

7.2 At the 187th meeting on 29 January 2005, the SCCLR considered the draft drafting instructions in respect of the auditing provisions in the Companies Ordinance and mock-up of the proposed auditing provisions prepared by the JWG.

7.3 As a result of the discussion, members endorsed the proposals made by the JWG to improve, modernise and simplify the auditing provisions of the Companies Ordinance as follows :-

(a) The basic sequence of the auditing provisions should be

\textsuperscript{28} Please see paragraphs 6.1 to 6.3 above.
re-arranged in a more coherent and logical manner.

(b) The auditing provisions should be improved to make them more user-friendly and comprehensible.

(c) The reforms should be based on the draft clauses in Part 6 of the Companies Bill contained in the White Paper ‘Modernising Company Law’ issued by the UK Department of Trade and Industry on 16 July 2002 on the understanding that these should be further reviewed when the United Kingdom Company Law Reform White Bill was published.

(d) Auditors’ rights to obtain information should be significantly enhanced on the basis of sections 389A and 389B of the United Kingdom Companies (Audit, Investigations and Community Enterprise) Act 2004. Note 29

(e) Auditors should be required to report on any inconsistencies between the audited financial statements and financial information contained in other parts of the annual report; and on the auditable part of any directors’ remuneration report.

(f) Statements made by auditors in the course of their duties as auditors and in respect of their resignation as auditors should enjoy the benefit of qualified privilege. The privilege should also be extended to persons who publish any document prepared by the auditors in the course of their duties as auditors and in

Note 29 Section 389A of the Companies (Audit, Investigations and Community Enterprise) Act 2004 gives an auditor of a company the right of access at all time to the company’s books, accounts and voucher and allows him to require any of the persons such as officer or employee of the company, persons holding or accountable for any of the company's books, accounts or vouchers, etc. mentioned in that section to provide him with such information or explanation as he thinks necessary for the performance of his duties as auditor.

Section 389B sets out the offences relating to the provision of information to auditors.
respect of their resignation as auditors.

(g) Only accountants in public practice registered pursuant to the Professional Accountants Ordinance could be appointed as auditors.

(h) The law should clearly specify that an auditor’s term of appointment would automatically terminate upon the appointment of a liquidator.

(i) The statutory requirement under section 131(8)(b) of the Companies Ordinance that auditors’ remuneration should be fixed by company in general meeting should be repealed. The directors or the company in general meeting should have the right to fix the auditors’ remuneration.

(j) A company must provide relevant information to the proposed auditors.

(k) Auditors’ rights in relation to general meetings should be enhanced.

(l) An outgoing auditor should have the right to give an incoming auditor information that he became aware of in his capacity as auditor.

(m) An outgoing auditor should have the obligation to give an incoming auditor a statement of any circumstances connected with his ceasing to hold office that should in his view be brought to the attention of the members or creditors of the company.

(n) The resigning auditor should have the right to call an extraordinary general meeting of the company for the purpose of receiving and considering an explanation of the circumstances
connected with his resignation if the directors of the company failed to do so after receiving the resigning auditor’s requisition.

7.4 The JWG agreed that the proposals and the mock-up provisions should be further reviewed when the United Kingdom Company Law Reform White Bill was published.
CHAPTER 8

Consultation Paper on Proposed Amendments to the Securities and Futures Ordinance to Give Statutory Backing to Major Listing Requirements and Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules

Background

8.1 As part of its continuing efforts to strengthen Hong Kong’s securities regulatory regime, the Government conducted a public consultation on certain Proposals to Enhance the Regulation of Listing in October 2003 and published its Consultation Conclusions in March 2004.\footnote{The full text of the Consultation Paper and the Consultation Conclusions is available at the website of the FSTB at http://www.fstb.gov.hk/fsb}

8.2 To implement these policy conclusions, the FSTB proposed certain amendments to the Securities and Futures Ordinance (“SFO”) and the Securities and Futures Commission (“SFC”) drafted certain detailed proposed amendments to the Securities and Futures (Stock Market Listing) Rules (“SMLR”) as subsidiary legislation under the SFO. These proposed amendments were the subjects of two separate consultation papers. One was published by the FSTB on Proposed Amendments to the SFO to give Statutory Backing to Major Listing Requirements and the other by the SFC.
on Proposed Amendments to the SMLR.

8.3 In short, the Government’s proposals aimed at –

(a) empowering the SFC to make rules to prescribe listing requirements and ongoing obligations of listed corporations;

(b) extending the market misconduct regime of the SFO to cover breaches of the statutory listing rules;

(c) extending the power of the Market Misconduct Tribunal (“MMT”) Note 31 to impose sanctions on primary targets for any breach of the SMLR;

(d) empowering the SFC to impose civil sanctions on primary targets for any breach of the SMLR.

8.4 The SFC’s proposals were to codify certain major listing requirements into provisions in the SMLR following four basic principles –

(a) the requirements would relate only to disclosure;

(b) there would be no substantive changes from the existing Listing Rules;

(c) there would be no pre-vetting or approval requirement;

(d) the Stock Exchange of Hong Kong Limited (“SEHK”) would remain the frontline regulator.

Note 31 The MMT is a tribunal established under the SFO, which has the jurisdiction to hear and determine questions or issues in relation to market misconduct under Part XIII of the SFO. The MMT proceedings are instituted by the Financial Secretary. For further details, please see sections 251 and 252 of the SFO.
Recommendations

8.5 At the 187th and 188th meetings on 29 January and 5 March 2005, the SCCLR considered the two Consultation Papers.

8.6 As a result of the discussion, members supported in principle the proposal to give statutory underpinning to the major listing requirements and agreed that the areas identified in the Consultation Papers were appropriate matters which should be regulated by legislation. They also agreed in principle to the introduction of civil fines on issuers and directors for breaches of the statutory listing requirements but were generally of the view that the sanctioning role of the SFC and the SEHK and the MMT should be more clearly demarcated. Some members were also opposed to the proposal to hold issuers or directors liable for breach of the statutory rules on the ground of negligence.

8.7 In addition, members had raised concern on a number of practical issues and made suggestions as follows:

(a) The change to a “no pre-vetting” system should be gradual and the SFC should consider undertaking pre-vetting

Note 32 The proposal suggested that Listing Rules covering the following three areas should be codified:

(a) Financial reporting and other periodic disclosure such as annual and interim reports;
(b) Disclosure of price sensitive information; and
(c) Shareholders’ approval for certain notifiable transactions.

Note 33 At present, all disclosure materials of listed issuers have to be submitted to the SEHK for pre-vetting or other regulatory approval. The SFC proposed that such a practice should be stopped to reduce the administrative burden on listed issuers and market practitioners.
during the early stage of the change.

(b) The respective roles of the SEHK and the SFC in the regulatory framework should be clearly stated and explained to the public to avoid any possible misunderstanding.

(c) Any future arrangements for the current listing rules after the promulgation of the statutory rules, including any mechanism to deal with possible inconsistency or discrepancy between the two sets of rules, should be clearly stated.

(d) The Administration and the SFC should work closely with the SEHK in the planning and implementation of the proposal.

(e) Full and accurate information on all the proposed changes and the timing of those changes should be provided to the public for the consultation exercise.

8.8 A formal submission setting out the SCCLR’s comments and suggestions as outlined above was subsequently sent to the FSTB.
CHAPTER 9

The Recommendations of the Joint Government/HKICPA Working Group to Give Statutory Recognition to Accounting Standards upon the Removal of the Tenth Schedule of the Companies Ordinance

Background

9.1 At the 185th and 186th meetings on 27 November 2004 and 8 December 2004, the SCCLR considered the draft drafting instructions and mock-up of the accounting provisions of the Companies Ordinance prepared by the JWG and raised several issues that they considered should be referred back to the JWG for further consideration. One of the issues was whether accounting standards should be legally enforceable and, if so, by what means, if the accounting disclosure requirements in the Tenth Schedule of the Companies Ordinance were to be repealed. Note 27

9.2 The JWG’s original proposal was that the accounting disclosure requirements in the Tenth Schedule that were covered by accounting standards should be repealed. However, there should be no need to give the accounting standards statutory backing or recognition because the “true and fair view” requirement under sections 123 and 126 of the Companies Ordinance already had the effect of requiring directors of companies to prepare accounts in accordance with generally accepted accounting standards in Hong Kong. As a result, the
accounts would not be in compliance with the Companies Ordinance if they did not comply with accounting standards.  

9.3 The JWG revisited the issue taking into account the views and comments of the SCCLR. As a result, the JWG recommended that, in addition to the original proposal to repeal the majority of the provisions in the Tenth Schedule, paragraph 36A of Schedule 4 to the UK Companies Act 1985 should also be adopted. The effect of the revised proposal was that accounting standards would be given statutory recognition, even though non-compliance with such standards would not itself be an offence.

**Recommendations**

9.4 At the 188th meeting on 5 March 2005, members considered a Paper prepared by the Companies Registry on the JWG’s revised proposals to give statutory recognition to accounting standards upon the removal of the Tenth Schedule of the Companies Ordinance.  

9.5 Given the fact that the revised proposal had wide policy implications, the Administration considered it more appropriate that it should be deliberated by the SCCLR, together with other related proposals, at a later stage after the Administration had had the chance to assess the implications of such a
proposal including, if necessary, consultation with the relevant stakeholders such as the HKICPA. In view of this, members had not entered into in-depth discussion of the revised proposal but had only given some preliminary views on a number of broad issues, such as the pros and cons of codifying accounting standards and the overseas experience in this respect.